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# Role of the public sector in promoting the economic development of developing countries

## Report of the Secretary-General

CONTENTS


| | | Paragraphs | Page |
|---|---|---|---|
| I. | INTRODUCTION | 1 - 3 | 2 |
| II. | NATIONAL ECONOMIC FRAMEWORK: ECONOMIC REFORM, STRUCTURAL ADJUSTMENT, DEVELOPMENT PRIORITIES AND ECONOMIC POLICIES | 4 - 35 | 2 |
| III. | MOBILIZATION OF NATIONAL RESOURCES: FINANCIAL RESOURCES AND HUMAN RESOURCE DEVELOPMENT | 36 - 67 | 9 |
| IV. | RATIONALIZATION OF THE ROLE OF PUBLIC ENTERPRISES AND THEIR EFFECTIVE OPERATION | 68 - 82 | 21 |
| V. | THE DEVELOPMENT OF APPROPRIATE RELATIONS BETWEEN THE PUBLIC SECTOR AND OTHER SECTORS | 83 - 87 | 25 |
| VI. | ACTIVITIES OF THE UNITED NATIONS SYSTEM | 88 - 89 | 26 |
| VII. | CONCLUSIONS | 90 - 93 | 27 |


* A/46/50.

# I. INTRODUCTION

1. This is the fourth comprehensive report of the Secretary-General on the role of the public sector in promoting the economic development of developing countries submitted to the General Assembly, through the Economic and Social Council, at the request of the Council. The General Assembly recognized the importance of the role of the public sector in promoting economic development in developing countries and reviewed a comprehensive report on the activities of the United Nations system in facilitating the exchange of experience and information on this role every four years, starting in 1979. In its resolution 1987/92 of 9 July 1987, the Economic and Social Council took note of the third comprehensive report (A/42/138-E/1987/50) and invited the Secretary-General to submit, through the Council, a further comprehensive report to the General Assembly at its forty-sixth session, paying special attention to the provisions of paragraph 5 of General Assembly resolution 34/137 of 14 December 1979: the role of the public sector in the mobilization of national resources for social and economic development; the role of public enterprises as the main instruments of the public sector and ways of increasing their efficacy; and the role of the public sector as a lever for introducing national development plans and establishing social and economic development priorities; and the role of the public sector in relation to other sectors of economic activity.

2. In preparation for the report, the Economic and Social Council, in its resolution 1987/92, requested that the role of the public sector in promoting the economic development of developing countries be studied in close cooperation with competent bodies and organizations of the United Nations system. Accordingly, the Secretary-General, through the United Nations Department of Technical Cooperation for Development, in cooperation with the United Nations Environment Programme (UNEP), conducted an interregional seminar on the role of the public sector in promoting economic development of developing countries at Nairobi, from 9 to 15 January 1991.

3. The present report focuses primarily on the experience of developing countries, with a special emphasis on ways of strengthening the public sector as a basis for promoting economic development.

# II. NATIONAL ECONOMIC FRAMEWORK: ECONOMIC REFORM, STRUCTURAL ADJUSTMENT, DEVELOPMENT PRIORITIES AND ECONOMIC POLICIES

## A. International dynamics

4. In the past four years, dramatic and far-reaching changes have occurred that profoundly affect the situation facing national economies and in turn the public sectors in developing countries. Among these changes are recent developments towards a market economy in the Union of Soviet Socialist Republics and several East European countries; the continuing Chinese policies of open economy; the movement towards divestment of public enterprises in many

developing countries and developed market economies as well; the realization in many developing countries, particularly in some Latin American and Sub-Saharan African countries, that they have reached or even surpassed the limits of the external debt and servicing obligations that they can bear realistically; a growing awareness of the real and potentially deleterious effect of certain economic development efforts on the environment and natural resource base; the significant disparities in growth rates among countries carrying severe social, economic and political consequences; and the extent to which globalization has occurred, connecting the world's economies and making them far more interdependent and hence more vulnerable to external economic shocks. It is noted, however, that many countries, Asian countries in particular, have continued to benefit from the global recovery and their economic performance has been most satisfactory.

5. In responding to and accommodating the changing international situation, developing countries face a variety of challenges in designing, or revising, and implementing plans for development that meet the economic and social needs and expectations of their rapidly growing populations. One reality facing developing countries is that funds for development are shrinking, both nationally and from external sources, and that there is increased competition for those funds. Concerns exist among developing countries about the increased competition for international development funds as a result of the integration of former Eastern bloc countries into the world economy, as these economies also need additional infrastructure, agricultural and industrial development, institution-building in support of market-based economies, social development and continuing provision of basic services.

6. Another international dynamic is the further evolution of a global trading system characterized by declining commodity prices and distortions stemming from the many non-tariff trade barriers being employed throughout the world. Many developing countries have experienced significant declines in their terms of trade, owing largely to lower commodity prices for their exports. These negative trade consequences have adversely affected debt and economic development in numerous countries producing primary commodities. Sub-Saharan Africa and Latin America experienced the most pronounced declines in terms of trade in the 1980s, incurring 15 per cent and 13 per cent reductions, respectively, in the purchasing power of exports in terms of real imports relative to the 1970s. These reductions of export earnings in many countries can be attributed in large part to declining prices for oil exports.

7. Inflation remains a serious problem in many developing countries, though some who endured spiralling inflation through much of the decade, such as Argentina and Bolivia, finally gained some control and by the end of the 1980's decade achieved more manageable levels. Debt-servicing obligations continue to constrain development severely and, moreover, continued external borrowing, when available, frequently finances current consumption rather than investment. In 1988, for example, debt-service obligations constituted substantial percentages of export earnings: 25.7 per cent for Nigeria, 39.6 per cent for Indonesia, 31.9 per cent for Jordan and 77 per cent for Algeria.

8. Public sectors continue to play the key role in directing the development process, and it is now recognized that transforming the public sectors to make them more effective, efficient and capable is imperative. In some cases this will entail modifying the public sectors' implementation role in production and commerce, in favour of serving as promoter and facilitator of development, including building a legislative, judicial and regulatory framework that supports the development of viable market-oriented economic activity and decision-making.

## B. Economic reforms

9. Accompanying these international dynamics is the recognition that internal economic factors are equally significant. An important development in the last four years has been the acceptance of a certain urgency and need for domestic reforms to foster development adjusting to the changed conditions. Economic reforms are inherently difficult to design and implement, owing to the complex interrelationships among sectors within the economy. Most developing countries recognize the need for reform, but determining the proper mix and timing of reform measures remains elusive.

10. There was a particular emphasis in many developing countries in the 1980s on financial reforms, with liberalization of the financial sector and growth of the private sector among the primary goals. Reforms undertaken in the 1970s and 1980s in Argentina, Chile and Uruguay, for example, attempted to expand and deepen the financial sector through developing capital markets, deregulating interest rates, broadening access to credit and creating a financial environment that would encourage capital investment rather than capital flight.

11. Economic reform in most countries aims at stabilizing the economy, particularly in terms of inflation and exchange rates, which is conducive to longer-term economic restructuring. Reform measures in pricing, taxes, interest rates and exchange rates can result in significant shifts in economic activity.

12. During the 1980s, within economic reform frameworks, many countries found that the development of a strong private sector along with an efficient public sector is considered critical for self-sustainable development. Further, most recognize that the coexistence of strong private and public sectors may, in many countries, involve a transition. Presently, many developing countries have sizeable public sectors, sometimes criticized as being inefficient and oversized, with relatively underdeveloped private sectors lacking access to resources.

## C. Integrated financial management

13. Governments in many developing countries express the need for improved financial management systems. These Governments identify various weaknesses, which of course vary quite widely in extent and nature. Some common features are the lack of coordination between recurrent and development budgets, untimely and inaccurate government accounting information, inadequate observance of financial rules and internal control on accountability, and inadequate links between the processes of financial management systems. For instance, while the budget is normally prepared on a programme and appropriation account basis, such as dams for flood control, the accounting is generally done on an organizational and object classification basis, such as personnel and purchase of equipment, unrelated to the particular programmes for which the money was appropriated. Harmonization of the financial process is essential for high performance management.

14. Most developing countries have undertaken various financial reforms in order to improve financial management in the areas of the budgeting, accounting and auditing system, and thus to achieve greater efficiency in the public sector. Among such measures is the adoption of accrual accounting to facilitate policy formulation, management and control of resources and effective audit. Performance auditing is widely recognized as the appropriate tool to determine the efficiency, effectiveness and significance of government programmes. The necessary institutional mechanism has been established to create a link between the recurrent and development budgets. Many Governments have also taken steps to upgrade accounting skills to ensure a more accurate and timely recording of government transactions. The use of financial information systems facilitates budgeting and simultaneous examination of all institutional activities and programmes to allocate effectively the limited resources among competing needs. Financial information systems could strengthen strategic operation and smooth inter-agency coordination.

## D. Structural adjustment

15. Many countries have undertaken major structural adjustments, targeting and implementing measures designed to promote shifts and diversification of the economy and greater reliance on the market mechanism than government controls. Adjustment measures have included adopting new budget processes that attempt to reduce budgetary deficits within acceptable limits, to allocate resources for new priorities, chosen on the basis of productive potential, and withhold resources from unproductive endeavours.

16. Many countries have approached macro-economic change through privatization and divestiture activities, many doing so at the urging of lending organizations. Bangladesh and Chile are among the countries that have implemented wide reprivatization programmes. Other countries have experienced varying success in these privatization endeavours.

17. Governments have found that privatization is not a quick cure-all remedy, but rather a complicated and difficult economic strategy. An evolving private sector, working within an environment of underdeveloped financial markets and irregular access to the inputs of production and distribution and outlets for consumption, usually lacks the tools necessary for overhauling the huge, formerly State-owned enterprises and activities effectively. One reason for the difficulty is that typically the public enterprises selected for privatization are those with the worst performance records and most profound structural problems.

18. The success of structural adjustment ultimately seems to depend upon implementing legislative, political, social, as well as economic reforms in support of economic changes. Within this evolving economic arrangement, the public sector participates far more in designing regulatory and policy frameworks that ensure access to and efficient use of resources and far less in setting production targets, interest rate ceilings and the like. Accounting practices are typically selected and shaped to reflect and support a given policy framework. With the adoption of a new policy and regulatory framework, new accounting principles and practices need to be established and, where necessary, technical expertise in using the new practices has to be gained.

19. International lending institutions, among them the Bretton Woods institutions, have advocated structural adjustment within the context of approving new and rescheduling old loans. During the 1980s, many developing countries were asked to adopt specific structural adjustment objectives as a condition of loan agreements. Countries argue that frequently these specific measures were inappropriate considering their particular conditions. Obviously, conditions vary widely and reforms that yield positive results in one country may prove disastrous in another. The application, timing and sequencing of reforms must be formulated in relation to each country's circumstances.

## E. Establishing economic and social development priorities

20. Establishing priorities for economic and social development, given the rapid global changes in evidence, is perhaps the greatest challenge facing developing countries. The Government typically retains the largest role in determining priorities and formulating and even implementing development policies.

21. The presence of Government in the process of establishing social and economic development priorities can be grouped into three broad categories.

22. Firstly, making certain policies that only Governments can make: macro-economic policies addressing poverty and income inequalities, fiscal and monetary policies, and legal regulations. While the "invisible hand" of the market may be adept at operating an economy, the visible hand of the Government is often needed to preserve the priorities and to provide rules of the game for fair competition in the operation of the economy.

23. Secondly, Governments have traditionally played a major role in providing a whole host of economic infrastructure and social services. These include mass transporation systems, power, communications, education, especially the eradication of illiteracy, health services and social services. Such services are not only the basic duties of the Government, but are also critical to the achievement of development goals.

24. Thirdly, Governments often intervene in markets to assume responsibilities that could not easily be assumed by individuals, including protection of the environment, and law and order. One priority of the Government is to provide a legal framework and a judicial system that ensure the safety of individual life and property and foster economic activities. These systems must be transparent and objective in their intent and operation, lending some degree of certainty and predictability to the economy.

25. Many Governments participate directly in production activities with the aim of protecting consumers from the consequences of market failure. However, many Governments are placing a greater reliance on competitive markets, both for the private and the public sector. This means that public enterprises would be subject to market determinants, competitive pressures, agreed-upon standards and balance-sheet accountability just like private enterprises. To function under these market conditions, public enterprises may need to be relatively freer from government regulations and control.

26. A prerequisite for market development and economic growth is the development of adequate entrepreneurial and managerial capabilities. Primary responsibility for gaining and nurturing the diverse skills required in different sectors of the economy will fall to the public sector. Through workforce analysis and development planning exercises, Governments are providing or encouraging the provision of educational opportunities for the full range of academic, vocational and managerial needs.

27. Given continued global instability and regional conflicts, defence will remain a priority for many developing countries and Governments will have to bear the responsibility of funding military expenditure. Through the 1980s, defence spending constituted a huge portion of the budget outlays of developing countries. In 1988 for example, defence spending as a percentage of total government expenditure was 29.5 per cent in Pakistan, 25.7 per cent in El Salvador, 27.1 per cent in the Republic of Korea, 26.5 per cent in Jordan and as much as 40.4 per cent in the Syrian Arab Republic. There is an increasing realization of the effects of defence expenditure on economic and social development and the need for global and regional peace.

28. There is also a growing realization of the impact of public policies on the environment and the natural resource base, which are being systematically degraded. Examples abound to support this premise: rampant desertification, extinction of species, climate changes, including depletion of the ozone layer, industrial mishaps involving nuclear leakage and dangerously high pollution levels. Governments of both the developed and developing countries are realizing the need to adopt appropriate environmental management

strategies both unilaterally and in the framework of regional and international cooperation. Two objectives or standards for sound environmental management are that the quality of the human environment must be protected and that harvesting of renewable or non-renewable natural resources must be carried out on a sustainable basis.

## F. National planning

29. In the 1980s, many developing countries achieved the development goals outlined in their multi-year plans, but many fell short. Rather than ignore the planning process, Governments have recognized the need for greater but more realistic and indicative planning efforts. International and domestic challenges require enhanced short- and long-term perspective planning and policy formulation pertaining to the trade regime, the financial sector and the regulatory framework.

30. Since the model of centrally planned targets for production and distribution has seldom achieved the desired outcomes, economic planning will gradually shift and take on more of an "indicative" character. Indicative planning is crucial in efforts to shift from monoculture economies to diversified ones: planners need signals from the economy regarding the viability of various activities and then at some point they need to demonstrate that a new priority area has been selected for support.

31. Indicative planning relies more heavily on feedback from the economy, including market performance indicators and information gathered through project analysis and evaluation. The development of institutional capacity to monitor, regulate, analyse and evaluate the development process regularly is a key factor, as is the integration in planning of information accruing from these activities.

32. A profound challenge for planners is trying to determine the content, sequence and timing of reforms, to balance multi-sector development instead of concentrating on single-sector development, such as oil, and to design alternatives and fine-tuning adjustments that can be implemented. Flexibility must be built into the system during the planning process. Some Governments indicate that they try to balance flexibility and commitment, while maintaining the ability to monitor performance and to make appropriate modifications.

33. Many Governments have decided that monopolies and preferential production relationships that evolved during periods of heavily centralized planning need to be reviewed with the aim of examining potentially productive rearrangements. Where Governments have chosen to encourage competition, some stockholders may lose part of their power and control over resources. The potential consequences of temporary or permanent dislocation are important considerations for planners. A key element of the planning challenge is to create adequate stability and incentives for all people to participate in and benefit from economic development.

### G. Developing effective institutional and technical capacities

34. In many developing countries there is already evidence of a discernible shift in the role of the Government from direct engagement in operations to management of the economy and regulation of economic behaviour through restructuring markets. In trying to improve the institutional and technical capacities of the public sector for development, there is a need to address issues like fiscal and monetary policies, income distribution, price systems and budget allocation. In addition to traditional government provision of necessary social services, the objectives of Governments include improving the ability of the Government to stimulate economic growth, improving the efficiency of operations all round and creating an environment for promoting and sustaining rapid economic growth without simultaneously weakening political institutions.

35. Development of human resources is an integrated part of effective institutional and technical capacities. This includes such issues as provision of education, health and technical skills. It would be imperative to expand vastly the facilities in these areas while simultaneously improving their quality. It is widely believed that improvement in the quality and motivation of staff, as well as their enterpreneurial and managerial capacities, has an important bearing on economic development.

## III. MOBILIZATION OF NATIONAL RESOURCES: FINANCIAL RESOURCES AND HUMAN RESOURCE DEVELOPMENT

36. The public sector has a role to play in the mobilization of national resources for development, as do various market forces. Complete reliance on market forces has limitations; many development issues require some forms of state intervention, especially in developing countries with poorly developed markets.

### A. Mobilizing financial resources for development

#### 1. Domestic savings

37. Domestic savings consist of public and private savings. Domestic savings as a ratio of GDP for the low- and middle-income group of developing countries were 25 per cent in 1987, indicating an increase of 7 percentage points from 1965. This reflects more availability of domestic resources for investment. Public savings in developing countries were consistently negative based on regional average in 1987 (see table 1). Public savings as a percentage of GDP were -7.7 per cent for the low- and middle-income group in 1987. For countries where the record of formation of private savings is poor, this shortfall of public savings is indeed critical.

Table 1. Gross domestic savings by region, low- and middle-income economies, 1987

| Region | GNP per capita (weighted average) United States dollars | As a percentage of GDP (weighted average) Gross domestic savings | Public savings a/ | Private savings b/ |
|---|---|---|---|---|
| Low- and middle-income | 700 | 25 | -7.7 | 32.7 |
| By region | | | | |
| Sub-Saharan Africa | 330 | 13 | -- c/ | |
| East Asia | 470 | 35 | -- | |
| South Asia | 290 | 19 | -8.5 | 27.5 |
| Europe, Middle East and North Africa | 1 940 | -- | -7.2 | |
| Latin America and the Caribbean | 1 790 | 20 | -10.2 | 30.2 |
| Highly indebted countries | 1 430 | 21 | -9.2 | 30.2 |

Source: World Development Report 1989, pp. 180, 181, 184 and 185.

a/ Current account budget surplus or deficit.

b/ Residual of gross domestic savings and public savings.

c/ -- means data not available.

38. Household savings provide the source of finance for Government and corporate business. In this regard, the Government can play an important role in boosting household savings by assisting people in deferring consumption in favour of investment, generally through easier access to financial institutions and better financial intermediation. On the one hand, in some countries, there is a pressing need to strengthen and/or re-establish an operational framework for the formal banking system. Renewal of the banking system may include policy measures such as regulated money and capital markets. On the other hand, informal arrangements are also efficient in mobilizing household savings in remote areas or low-income households, especially where the formal commercial banks are not willing to provide financial services in those areas because of the high costs involved. Household savings can be maximized where productive linkages can be encouraged between informal savings and loan associations and the formal financial institutions.

### 2. Interest rate policy and growth in domestic savings

39. One of the important measures with respect to mobilizing domestic savings is the adoption of an interest rate policy that ensures that interests on deposits are positive in real terms. In addition, lending rates must be consistent with risks as perceived by the lending institutions, except where the Government, because of socio-economic conditions, wishes to subsidize interest rates from budgetary resources. The true costs of so doing should in any event be reflected in the cost accounting of public sector activities supported by subsidized loans.

40. Initiatives to liberalize interest rates as embodied in structural adjustment programmes sponsored by the International Monetary Fund (IMF) and the World Bank can, in certain developing country situations, overburden borrowers where financial markets are weak or monopolistic. This is most apparent in the case of the Sub-Saharan African countries. It is imperative, therefore, that in pressing for the liberalization of interest rates, due consideration should be given to the existing state of the financial system. Experience in Latin American and Asian countries also suggests that liberalization of interest rates is hindered by high or widely fluctuating inflation.

41. Measures for improving financial intermediation have to be pursued in tandem with a cautious approach to liberalization of interest rates. For a broader financial market base to be constructed, with greater in-depth intermediation capability, experience from some countries indicates the importance of adopting a legal framework that permits relatively free entry into and competition in the financial market. This framework is lacking in a number of developing countries where Governments have nationalized financial institutions and created State monopolies in their place. Financial reforms in a number of developing countries have attempted to improve market competitiveness and in this way to enhance the capability to mobilize and allocate domestic savings more efficiently.

### 3. Government revenues

42. Government revenue tends to increase over time in order to match increases in public spending. The increment is larger in higher income countries. For instance, the central government current revenue as a percentage of GNP was 29.3 per cent in 1987, an increase of 5.9 percentage points from 1972 for the upper-middle income group of developing countries, but was only 15.9 per cent in 1987, an increase of 1.7 percentage points from 1972, for the low-income group of developing economies.

43. Generally speaking, the low central government revenue and its slower growth path in low-income economies could be attributed in large part to weaker commodity prices and the low rate or even stagnation of economic growth. Besides, it is generally believed that the tax potential in many low-income countries has not been fully exploited. Another major cause of poor revenue performance is tax evasion as a result of laxity in tax administration.

44. Tax revenue has continuously accounted for about 80 per cent of government finances, although it experienced a minor decrease in terms of its ratio to government current revenue between 1972 and 1987 (see table 2). There were no significant shifts in the structure of taxation away from indirect taxes towards direct taxes during the periods 1972 to 1987. The tax structure varies among country groups, however. Within the developing economies, the major sources of tax revenue come from taxes on international trade and transactions in low-income economies, particularly in Sub-Saharan Africa. This is in contrast with the major source from taxes on domestic goods and services in lower-middle income economies, and from taxes on income, profit and capital gains in upper-middle income economies. In countries such as Lesotho, Mauritius and Uganda, taxes on international trade and transactions accounted for more than 50 per cent of total government current revenue in 1987. The dependence on taxes on international trade reflects the extent of the openness of the developing countries and dependence of the economy on external transactions.

45. Different measures of tax reform have been taken by many developing countries with varying degrees of success. Tax reforms have concentrated on expanding the base, thus avoiding the higher tax rates and adverse effects on incentives, in such countries as Colombia, Indonesia, Jamaica and Malawi. They have also tried to promote equity by limiting tax deductions from the wealthy and by avoiding taxes on the poor. Some tax loopholes were closed in the 1989 tax reform in Guatemala. The wholesale tax was eliminated as a means of stimulating investment incentives in the 1983 tax reform of Indonesia. A value added tax was introduced with the objective of generating substantial revenue, with fewer distortions than import or excise taxes, in such countries as Brazil, the Republic of Korea and Turkey. Finally, tax reform is a long-term task and requires periodic changes in order to take account of external circumstances and internal needs, as was undertaken in Colombia in a series of major tax reforms in 1953, 1960, 1974 and 1986.

Table 2. Central government current revenue structure by major income group, 1972 and 1987

| Income group | GNP per capita United States dollars a/ 1987 | As a percentage of central government total current revenue a/ | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Tax revenue | | | | | | | | | | | |
| | | Taxes on income profit and capital gain | | Domestic taxes on goods and services | | Taxes on international trade and transactions | | Taxes on security contribution | | Other taxes | | Current non-tax revenue | |
| | | 1972 | 1987 | 1972 | 1987 | 1972 | 1987 | 1972 | 1987 | 1972 | 1987 | 1972 | 1987 |
| 1. Developing economies (51 countries) | n.a. | 23.0 | 23.3 | 22.2 | 27.0 | 24.8 | 20.2 | 6.9 | 6.5 | 5.7 | 4.1 | 17.4 | 18.9 |
| Low-income | 291 | 25.3 | 21.7 | 24.2 | 27.4 | 32.6 | 31.3 | 0.0 | 0.2 | 3.4 | 3.2 | 14.5 | 16.2 |
| Lower-middle income | 1 200 | 19.6 | 24.8 | 25.1 | 31.5 | 27.0 | 18.1 | 5.3 | 4.2 | 7.4 | 4.4 | 15.6 | 17.0 |
| Upper-middle income | 3 032 | 24.0 | 23.5 | 17.3 | 22.0 | 14.9 | 11.2 | 15.3 | 15.2 | 6.4 | 4.7 | 22.1 | 23.4 |
| 2. Developed market economies (18 countries) | 12 049 | 33.4 | 34.2 | 28.6 | 26.9 | 4.7 | 1.8 | 20.6 | 24.7 | 4.8 | 2.0 | 7.9 | 10.4 |

Source: Computed from World Development Report 1989, pp. 186 and 187.

a/ Computation based on unweighted average.

/...

46. Tax reform alone will not be sufficient to augment public revenues. Tax administration in most developing countries also needs to be reformed to improve tax collections, tax audit procedures and overall tax policy organization. The Indonesian experience is an example of positively affecting an increase in public revenue through a broad-gauged reform approach. After initiating a series of major policy adjustments accompanied by tax rate schedule and tax administration reform, non-oil source taxes increased from 7 per cent in 1984 to 11 per cent in 1990 of non-oil GDP.

## B. Government expenditure and budget deficit

### 1. Government expenditure and expenditure rationalization

47. During the 1960s and 1970s, there was a rising trend of recurrent expenditure in most countries, particularly in the hiring of staff. However, in the 1980s financial constraints obliged most Governments to regulate the accelerating growth in public spending.

48. Central government expenditures as a percentage of GNP for the developing economies as a group was 26.5 per cent in 1987, with an increment of 4.9 percentage points from 1972. Two major observations can be made on table 3 concerning the functional categories of central government expenditure classified by major income group for 1972 and 1987. Firstly, in comparison with the situation in a developed market economy, the proportion of expenditure is higher in economic services but lower in housing, amenities, social security and welfare in the developing economies. Secondly, within both developing and developed economies, rigorous structural adjustment was not accompanied by drastic change in the functional structure of central government outlay between 1972 and 1987.

49. There is a trend to encourage Governments to contain expenditures in line with budget revenues. This requires rationalization and reform measures applied broadly to public sector activities, in particular the cutting of subsidies to public enterprises, tighter control of public sector wages and lower military spending.

50. In many developing countries, the relatively low level of public spending and its sharp reduction during the structural adjustment period resulted in shortages of school textbooks, lack of medicines and negligence in the maintenance of infrastructure. As has been seen in Costa Rica, economic and social infrastructure has been adversely affected by budgetary cuts. In this connection, the experience of some Governments reveals that the need for maintaining some key areas of programmes such as social and infrastructure services does not necessarily imply the need for an increase in public expenditure. Much can be done through better targeting and allocation of expenditures, strengthening of public sector management and enhancement of the involvement of local communities.

Table 3. Central government expenditure structure by major income group, 1972 and 1987

| Income group | As a percentage of central government expenditure a/ | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Defence | | Education | | Health | | Housing, amenities, social security and welfare | | Economic services | | Other b/ | |
| | 1972 | 1987 | 1972 | 1987 | 1972 | 1987 | 1972 | 1987 | 1972 | 1987 | 1972 | 1987 |
| 1. Developing economies (37 countries) | 14.8 | 14.4 | 14.5 | 14.3 | 5.8 | 6.1 | 10.9 | 11.1 | 24.2 | 20.2 | 29.8 | 33.9 |
| Low-income | 12.8 | 11.6 | 14.4 | 12.3 | 5.8 | 5.1 | 5.2 | 4.6 | 25.5 | 26.9 | 36.3 | 39.5 |
| Lower-middle income | 14.2 | 14.6 | 16.1 | 15.2 | 5.0 | 6.1 | 13.0 | 12.0 | 23.7 | 19.7 | 28.0 | 32.4 |
| Upper-middle income | 17.5 | 16.9 | 13.1 | 15.3 | 6.5 | 7.2 | 14.6 | 16.8 | 23.3 | 13.9 | 25.0 | 29.9 |
| 2. Developed market economies (15 countries) | 12.3 | 9.2 | 10.6 | 8.0 | 8.6 | 8.5 | 35.5 | 36.2 | 15.0 | 11.4 | 18.0 | 26.7 |

Source: Computed from World Development Report 1989, pp. 184 and 185.

a/ Computation based on unweighted average.

b/ "Other" covers expenditure for the general administration of Government not included elsewhere; for a few economies it also includes amounts that could not be allocated to other components.

## 2. Budget deficit and deficit reduction

51. Capital and current budgets in most developing countries came under increased pressure throughout the 1980s. The chronic trend of budget deficits in the 1980s as shown in table 4 would suggest that budgetary deficits will continue to pose a major problem for economic policy in most developing countries in the 1990s, although many countries have made efforts through structural adjustment to contain these deficits. The concern with budget deficits is not only with the increasing burden of interest payments, but also, more importantly, with their negative impact on economic performance in terms of inflation, high interest rates, the disincentive to make private investments and increased unemployment - the so-called "crowding-out" effect.

Table 4. Central government fiscal balance as a percentage of GDP, developing countries, 1981-1989

| Region | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 | 1989 |
|---|---|---|---|---|---|---|---|---|---|
| Developing countries | -3.8 | -5.3 | -5.3 | -4.6 | -4.2 | -6.0 | -6.0 | -5.8 | -4.8 |
| By region | | | | | | | | | |
| Africa | -5.7 | -6.8 | -7.6 | -5.1 | -4.8 | -6.1 | -7.9 | -8.0 | -6.5 |
| Asia | -3.1 | -4.2 | -3.3 | -2.7 | -3.0 | -4.1 | -3.6 | -3.7 | -3.9 |
| Europe | -4.7 | -2.5 | -2.4 | -2.6 | -2.7 | -2.1 | -2.1 | -2.2 | 2.7 |
| Middle East | -2.6 | -6.8 | -10.0 | -10.2 | -8.2 | -13.9 | -12.5 | -13.0 | 11.8 |
| Western hemisphere | -4.1 | -6.2 | -4.8 | -3.8 | -3.3 | -4.7 | -5.6 | -4.8 | -2.2 |

Source: International Monetary Fund, World Economic Survey, Washington, D.C., April 1988, p. 144.

52. A major factor influencing deficit-creation has been the increase in recurrent expenditure emanating from past capital expenditures. The other major factor has been the large increase in defence expenditure, which is particularly destructive for poverty-ridden developing economies.

53. On the one hand, most developing countries in Asia, such as Indonesia, the Philippines and Thailand, have pursued rather cautious financial policies and have achieved impressive improvements in fiscal balance in recent years. India too adopted flexible expenditure and revenue policies in 1987 in order to prevent a sharp deterioration of the fiscal position during a severe drought. In China, delay in further price liberalization measures and tightening of credit controls were the major factors that prevented further acceleration of inflation and budget deficit. Similarly, several developing countries in the western hemisphere, such as Argentina, Brazil and Mexico, have improved their fiscal balances in recent years through the adoption of stabilization programmes. A few highly indebted countries in that region, notably Chile and Colombia, have pursued more prudent financial policies and have managed to contain inflation. Elsewhere, some African countries, such as Ghana, Senegal and the United Republic of Tanzania, have undertaken fiscal reforms to broaden revenue bases and to reduce expenditure, thereby achieving significant improvements in their fiscal positions in recent years.

54. On the other hand, highly indebted countries, such as Côte d'Ivoire and Nigeria, have continued to experience a sharp deterioration in their fiscal balance. This situation is attributed to a combination of factors, such as declining prices of oil and export commodities, poor production and narrow revenue base and relatively lax policies. Similarly, fiscal balances in the Middle Eastern countries have weakened considerably as a result of the sharp decline in oil revenues in the latter part of the 1980s.

## C. Foreign borrowing

55. Foreign borrowing continues to grow, although for most developing countries debt-servicing has reached levels that clearly will impair future growth options. It appears from table 5 that external debt as a percentage of GDP for developing countries as a group increased steadily, though not at the same magnitude every year, from 27.8 per cent in 1981 to a peak of 38.1 per cent in 1986, and then it gradually declined to 32.3 per cent in 1990. As much of this external borrowing is used to maintain unrealistic public and private consumption, including military expenditures, rather than investment, many developing countries are in effect mortgaging their future and seriously eroding their financial integrity.

56. The prospective global "liquidity crunch" is already becoming apparent in the form of "lender fatigue". Accordingly, it is unlikely that developing countries can expect that in the 1990s credit availability will expand. Further, while there is thus far little evidence to substantiate the fear, many developing countries anticipate that countries comprising the former Eastern bloc may receive loan preference, exacerbating the shortage of funds already in evidence.

Table 5. Total external debt and debt service, developing countries, 1981-1990

| Items | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 |
|---|---|---|---|---|---|---|---|---|---|---|
| 1. External debt as a percentage of GDP | | | | | | | | | | |
| Developing countries | 27.8 | 31.0 | 32.8 | 34.1 | 36.0 | 38.1 | 37.7 | 35.6 | 33.7 | 32.3 |
| By region | | | | | | | | | | |
| Africa | 31.4 | 35.4 | 38.2 | 41.9 | 46.9 | 49.8 | 48.6 | 49.8 | 50.5 | 49.9 |
| Asia | 18.6 | 21.4 | 22.5 | 23.4 | 26.1 | 28.8 | 27.6 | 25.1 | 22.5 | 21.3 |
| Europe | 34.2 | 34.7 | 37.1 | 40.6 | 44.5 | 42.9 | 45.1 | 42.3 | 39.1 | 37.1 |
| Middle East | 19.2 | 22.5 | 24.4 | 25.8 | 27.3 | 31.2 | 31.0 | 30.8 | 31.0 | 30.2 |
| Western hemisphere | 39.8 | 43.7 | 46.8 | 46.5 | 45.4 | 45.5 | 46.0 | 44.0 | 42.8 | 41.1 |
| 2. External debt as a percentage of exports of goods and services | | | | | | | | | | |
| Developing countries | 95.8 | 120.0 | 134.8 | 134.3 | 150.8 | 170.8 | 158.7 | 141.9 | 132.1 | 126.6 |
| By region | | | | | | | | | | |
| Africa | 119.3 | 154.5 | 170.6 | 170.5 | 191.3 | 244.9 | 249.2 | 248.9 | 241.9 | 243.9 |
| Asia | 73.8 | 87.1 | 92.5 | 88.3 | 101.8 | 103.0 | 89.1 | 76.1 | 69.6 | 65.7 |
| Europe | 136.9 | 145.0 | 149.1 | 145.4 | 160.5 | 168.4 | 169.0 | 146.2 | 133.9 | 127.0 |
| Middle East | 34.6 | 47.6 | 63.6 | 72.0 | 84.9 | 116.3 | 109.8 | 116.8 | 112.3 | 110.7 |
| Western hemisphere | 209.8 | 271.8 | 292.5 | 274.6 | 296.9 | 353.0 | 346.3 | 305.0 | 297.3 | 289.8 |
| 3. Debt service as a percentage of exports of goods and services | | | | | | | | | | |
| Developing countries | 16.2 | 19.7 | 18.6 | 20.0 | 21.3 | 23.0 | 20.3 | 19.6 | 18.9 | 17.5 |
| By region | | | | | | | | | | |
| Africa | 17.0 | 21.2 | 22.9 | 26.6 | 29.1 | 29.1 | 25.4 | 28.8 | 29.0 | 26.8 |
| Asia | 9.9 | 12.3 | 11.9 | 12.3 | 14.4 | 14.5 | 14.8 | 11.4 | 10.6 | 9.4 |
| Europe | 21.8 | 22.9 | 20.7 | 21.7 | 23.7 | 26.5 | 25.9 | 25.3 | 23.8 | 21.4 |
| Middle East | 5.0 | 6.5 | 8.3 | 10.0 | 10.3 | 14.0 | 12.6 | 12.8 | 12.6 | 12.3 |
| Western hemisphere | 43.9 | 54.0 | 43.3 | 42.7 | 42.1 | 47.2 | 37.0 | 41.6 | 43.2 | 43.0 |

Source: International Monetary Fund, World Economic Survey, op. cit., pp. 192-194.

57. An international debt reduction strategy has evolved in recent years. The so-called "market menu approach" has become an important element in the evolving debt strategy as far as debt owed to commercial banks is concerned. Under this market menu approach, which was supported by the international financial community, including IMF in 1987, the major debt reduction options to date have involved debt buy-backs and exchanges of existing debt for new instruments, including some collateral and swaps of domestic equity for foreign debt. Buy-backs have been used by Bolivia, Chile and Mexico, while the debt-equity conversions have been used by Chile, Brazil and Mexico.

58. Regarding bilateral official debt, a major step was taken on 21 June 1988 at the Toronto summit of seven major industrial countries (the "Group of Seven"). As a follow up to this initiative, in the autumn of 1988 the Paris Club of official creditors agreed on the following new options: partial write-off, extended maturities and concessional interest rates.

## D. The informal sector

### 1. Scope of informal sector activity

59. In virtually every developing economy there exists an active and on occasion extensive informal sector. Although central planning authorities and government statistical agencies often fail to account accurately for the total economic activity and human and financial resources involved in these informal sectors, there is growing evidence that in many countries the scope and range of activity and the money involved are quite substantial. For example, in Egypt it is estimated that informal sector activity may be equal to 35 per cent or more of formally recorded and reported GDP in 1989.

60. Accounting for informal sector economic activity poses a number of problems and difficulties. For the developing economies that continue to plan centrally, there is often a political motive in the failure to account fully for such activities, namely, that Governments do not wish to acknowledge formally that an active informal sector exists. In other instances, informal sector activity falls outside the accounting of formal economic flows in trade, finance and banking, remittances, manufacturing and services, and therefore fails to be recorded in officially prepared economic data. Finally, because informal sector activity may include transactions that are illegal (i.e. black market or illegal substances, arms, etc.) or quasi-legal, participants often go to considerable effort to avoid government attention being focused on their activity.

61. Despite this inadequate understanding of the informal sector's volume of economic activity, it is recognized that throughout the late 1970s and 1980s it assumed a larger role that must be considered in planning future economic development. The informal sector often provides a great deal of new employment in developing countries; it frequently preserves the stock of experienced private sector talent and entrepreneurship; it often generates considerable financial returns; and it adds to the stock of goods and services

available for public consumption, a particularly important function in countries where the organized enterprise sector increasingly fails to meet consumer demands for quantity and quality.

### 2. Providing incentives to the informal sector

62. Coupled with the need to revise national accounting practices to measure more accurately the economic contributions of informal sectors is the need to adopt policies that encourage responsible behaviour and productive growth in the informal sector. These policies should in the main seek to achieve higher rates of employment and an increased contribution to overall economic growth.

63. Of particular importance is the need to encourage increased savings in the informal sector, to make credit available through informal arrangements of financial institutions in remote and rural areas, to strengthen the links of the informal sector with formal financial institutions and to increase its contribution to economic development through improvements in infrastructure.

64. The international, bilateral and multilateral aid and technical assistance institutions should make a more serious effort to understand the scope and contribution of the informal sector in developing countries. Specific policies and practices of external assistance should likewise be directed to increasing the contribution of these sectors to the economy and, in particular, to employment.

## E. Human resources mobilization

65. Notwithstanding the importance of the mobilization of economic resources, the need for developing countries to mobilize human resources more effectively is imperative. People are both the ends and the means of development. Improved health, nutrition and education of human beings are not merely ends in themselves, but, most importantly, they are also the principal means for achieving development.

66. A long-term commitment to the development and mobilization of human resources must be made to ensure, in particular, a viable education and training system. Without this, few developing countries will possess the necessary qualified labour force for improvements in economic performance or the adaptation and assimilation of modern technologies upon which the attainment of overall development goals so vitally depends.

67. In Sub-Saharan Africa, the future development strategy calls for a broad-based development of human resources. The immediate priorities include the improvement of the quality and relevance of education at every level and redirection of public resources towards basic education, food security interventions, nutrition and primary health care. It is estimated that annual investment in people should rise from the present percentage of about 4 to 5 per cent of GNP to about 8 to 10 per cent of GNP in future development strategies by the year 2000 and beyond. This is higher than in countries such

as China, Mauritius, the Republic of Korea and Sri Lanka, which managed to ensure broad access to human resources by spending about 5 per cent of GNP. However, such higher financial requirements are needed for Sub-Saharan Africa, given the fact that their populations are widely dispersed and infrastructure generally poor.

## IV. RATIONALIZATION OF THE ROLE OF PUBLIC ENTERPRISES AND THEIR EFFECTIVE OPERATION

### A. Continuing dominance of public enterprises

68. Public enterprises remain the most explicit instrument used by many States to realize their economic and social policy goals. Despite recent criticism of public enterprises, focusing upon their inefficiency, high cost of operation, contribution to budgetary deficits and pressure for divestment, the public enterprise sector has not diminished to any significant extent.

69. In many developing countries where local entrepreneurship remains weak, the public enterprise sector retains its dominance and the immediate prospect of any significant divestment of its activities appears minimal. This tendency toward maintaining, if not expanding, public enterprise dominance is also buoyed by the fact that public enterprises do not always incur losses and that the means by which performance is measured vary significantly enough to call into question any hard and fast conclusions being drawn as to their overall value and worth.

#### 1. New pressures for rationalization of public enterprises

70. The dominance of the public enterprise sector has come under more direct question and pressure in the late 1980s and the beginning of the 1990s than at any other time in development history. This pressure has been built up in many developed and developing countries alike, not just to reform the public enterprises, but to undertake their divestment. The sentiment in favour of divestment is influenced both by a policy shift towards an increased role for the private sector on the part of the Bretton Woods institutions, as reflected in their various stabilization and adjustment policies, and political and economic changes in a number of countries in favour of political pluralism and market forces.

71. In the previously socialist economies of Eastern Europe, recent pluralistic political changes have led countries to reconsider their present economic structure. This reconsideration involves a major reassessment as to the appropriate role of public enterprises and is being conducted within the context of a definitive commitment to experiment with private enterprise and free market development. In the developing countries of Africa, Asia and Latin America, a combination of internal and external factors leading to increased pressure for rationalization of the public enterprise sector in the 1990s is in evidence. These factors include the need to reduce increased

budgetary deficits caused by government subsidies and public enterprises losses, to promote private sector growth and entrepreneurial development partly as a requirement for assistance from donors and lenders, and to bring efficiency and economy to the operation of the public enterprise sector.

72. In response to these pressures, two broad approaches, namely, privatization and reform, have been adopted in varying mixes to rationalize the public enterprise sector in developing countries. Privatization has included transfer of ownership to the private sector, including enterprise employees, introduction of private capital, transfer of management to independent professionals and transfer of capital assets to private stock holders through the capital market. Reform of public enterprises has included institutional and policy changes to clarify objectives and promote autonomy and accountability, introduction of competitive elements to promote enterprise efficiency and improvement of the management and control structure to ensure compliance with the objectives and goals of the enterprise.

## 2. Privatization

73. Privatization policies, encompassing a continuum from outright sale of an enterprise to the introduction of private capital, are currently followed in many developing countries. As is well-known, there have been massive privatization programmes in the United Kingdom, Japan and other major industrial countries. Some developing economies, for example, Argentina, Bangladesh, Chile, Jamaica, Mexico and Turkey, have also undertaken significant privatization activities. It may be worth specifying that Bangladesh and Chile implemented reprivatization of enterprises that had been nationalized by previous administrations. In other countries, privatization has been more original and selective. Enterprises that have been privatized included mostly utilities, banks and some manufacturing enterprises. For example, Mexico has effectively demonstrated a capacity to enhance the range and scope of public enterprise economic activity, relying mainly on the introduction of market forces and divesting inefficient undertakings. As such, its experience may become increasingly relevant to other countries contemplating reform of the public enterprise sector, particularly in terms of indicating the kind of policies that are likely to prove most useful. In another Latin American country, Argentina, one finds that even such vaunted icons of the public enterprise sector as the telephone system can nevertheless be sold off to the financial benefit of the public and result in real cost reduction.

74. Privatization policies have helped some developing countries to reduce the debt burden as well as the budgetary deficit by disposing of loss-making enterprises. These policies have also allowed access to private sector finance and new markets and have contributed to the development of domestic capital market. However, various economic and political difficulties associated with the process of privatization, such as proper valuation of an enterprise, absence of a capital market and prospect of heavy job loss, remain overwhelming. Even in situations where privatization has taken place, its

beneficial impact remains contingent upon effective regulations and competition. A regulatory environment must be in place to prevent privatized concerns from exploiting a monopolistic situation. Again, if the full efficiency gains that are potentially available through privatization are to be realized, one has to ensure that privatized markets are contestable. However, in many cases, privatization has not been followed by such a regulatory environment and competitive situation. In some cases, the process of privatization did not even lead to a net change in income flow or the financial position of the Government owing to the sale of public enterprises at below fair market prices. Privatization also often involves high transaction costs of selling public assets and the need to maintain some current transfers or subsidy to support specific social objectives (e.g. employment targets, low utility prices and developmental service).

75. However, despite these limitations, some forms of privatization policies are pursued in many developing countries. It is, however, debatable whether these policies will lead to any significant reduction in the size of public enterprises in developing countries. In the case of the socialist economies under transformation, the size of the public enterprise sector will shrink steadily. Although divestment is likely to prove considerably less dramatic in many developing economies, it will nevertheless probably prevent further public enterprise expansions and conceivably the aggregate size of the public sector may begin to diminish.

## B. Public enterprise reform

76. Public enterprise reform still continues to be the favoured alternative in the rationalization of the public enterprise sector in many developing countries. It should be noted that policy makers in many countries adopt reform programmes because the constraints and consequences of privatization alternatives (e.g. economic dislocations, sudden unemployment) are considered unacceptable. Policy makers also tend to believe that in the pursuit of development policies and objectives (e.g. social justice, eradication of poverty) a reformed public enterprise sector may be a more reliable instrument than premature privatization.

### 1. Institutional and policy reform issues

77. A significant segment of public enterprise reform aimed at enhancing operational performance has involved a review of the policy and regulatory environment as well as the need for autonomy in the management of the public sector. In this respect, experience in almost all countries tends to show that public enterprises have lacked clear objectives or, where clear objectives do exist, the means for their achievement and adequate administrative and financial powers are often lacking. A large number of decisions, such as personnel recruitment and wage and salary levels, are made by other government administrative organs with little consultation with the management of public enterprises. As a result, managers of public enterprises

have had little or no discretion to provide the required incentives to improve productivity. In addition, lack of management autonomy in making decisions in such critical areas as product design, marketing and distribution, product prices, financial resource mobilization and allocation, and the retention of profits to meet future capital expansion and working capital needs have made it still more difficult for public enterprises to become efficient and therefore effective in enhancing overall economic development.

78. A variety of reform approaches are being tried to clarify the objectives and control structures of public enterprises; to provide adequate flexibility and autonomy to management for making economic, financial and personnel decisions; to institute a system of monitoring and to provide improved transparency between public enterprise finance and the national budget; and to provide realistic evaluation of public enterprises' financial and economic performance. In many countries, these reforms are being tried under a rubric of performance contracts or some form of understandings. These measures are complemented in many countries by broad improvement measures in such areas as management and skill training of enterprise officials, corporate planning, budgetary and accounting systems, and management information and reporting systems. In non-commercial public enterprises providing social services, often at subsidized prices, the reforms aim at reaching a maximum possible degree of efficiency while minimizing the subsidy cost within the overall context of increasing public satisfaction.

79. Many of the above reform measures are being carried out by developing countries with assistance from various donors. In some cases these reform measures are producing positive results leading to improved enterprise performance. However, the results are uneven and continued efforts to sustain these improvements over a period of time will be necessary to produce durable improvements in performance.

### 2. Introducing market forces to improve efficiency

80. It is increasingly recognized that commercially oriented public enterprises could be exposed to competitive pressures through the introduction of market forces to attempt to enhance efficiency. These enterprises would be sufficiently divested from direct government interference if Governments want to experiment with maximizing the impact of market forces on enterprise operations and decision-making. There are a number of specific instances where public enterprises, freed from government administrative and regulatory dominance, have demonstrated a capacity to compete effectively (e.g. Ethiopian Airlines and Egypt's Suez Canal Company). In these cases the respective Governments have allowed enterprise management autonomy while simultaneously requiring accountability.

81. To assist public enterprises to operate in competitive environments would involve altering the regulatory environment within which public enterprises currently operate and placing any changes considered in this environment within the context of the "forward-and-backward linkage" issue. These changes

are basically akin to a corporate structure and the autonomy that a corporate management enjoys under the broad corporate goal of profitability. In the context of these changes, the "backward linkage" refers to the need for the Government to follow tax, foreign exchange, resource availability and other policies that make enterprise autonomy operable and effective. The "forward linkage" refers to the need to make both the newly autonomous public enterprises and any correspondingly similar private sector activity subject to the same competitive forces as defined and effected by government economic policies.

82. Significant changes continue to influence the public enterprise sector under the latest trends in rationalization focusing upon reform and privatization. Although globally the stock of public enterprises may not decline significantly, this sector will experience significant qualitative changes. The mix of public enterprise products and services will receive serious reconsideration. Few economies will have financial resources to continue to provide an inexhaustible range of goods and services irrespective of the economic and social costs involved. Economic affordability as much as political pragmatism will determine the social relevance of future decisions to alter or expand the scope and range of public enterprise sector goods and services.

## V. THE DEVELOPMENT OF APPROPRIATE RELATIONS BETWEEN THE PUBLIC SECTOR AND OTHER SECTORS

83. The role of the public sector and the relations developed and maintained between it and other sectors, for example, the private, mixed, cooperative, private voluntary non-governmental organizations, etc., vary from country to country. Any rethinking of the role of the public sector or follow-through on the results of this rethinking necessarily has implications for the set of intersectoral relations as this affects the promotion of economic development.

### A. Trends in changing relationships

84. There is a trend observed towards permitting and encouraging a greater role for the private sector in many countries. This trend is especially evident with respect to the changing character of the rule of law and rights therein regarding the ownership of private property.

85. This changing and often enhanced role of the private sector does not appear thus far to have decreased significantly the importance of the public sector, which must, under existing legal and organizational conditions, still provide the enabling environment necessary for growth in the private sector. In addition, the public sector remains the key to providing an appropriate economic policy environment to induce a greater private sector contribution to overall economic development growth and change.

### B. Implications of these trends for intersectoral relations

86. Government policy to strengthen the private sector results in a more balanced relationship between public and private sectors. During the strengthening period, both sectors are changing; for instance, the public sector is increasing in efficiency and the private sector is assuming appropriate functions previously performed by the public sector. Public enterprises are pivotal institutions in this transition process. The case of Poland may be instructive to other countries as an example of careful formulation of such a transition. Poland appears to be further along than its Central and Eastern European neighbours in a workable restatement of the "rules of engagement" between the public and private sector. In so doing, the redefinition of the role of the public sector in enhancing the growth and contribution of the private sector to national development is proving of pivotal importance.

87. Further, the experience of Governments in constructing an effective and fair transition phase leads to certain basic principles for both the public and private sectors:

(a) Equality: there must be similar treatment of all sectors with ownership decisions carried out in a non-discriminatory manner and consistent with who can perform needed economic and social functions better;

(b) Legal and contractual relationship: interactions, including economic transactions, between the public and private sectors must be based on the rule of law applied without exception;

(c) Stimulating economic initiative: the public sector must develop an institutional framework, including facilitating and support services and appropriate incentives, for the purpose of encouraging economic actors at various levels (e.g. national, regional and local) to undertake investment and other business activity in a competitive environment;

(d) Altering the balance of direct and indirect public sector involvement: while the public sector will initiate many economic activities, it should seek over time to diminish its direct involvement in public enterprises while proportionately expanding its indirect involvement in the form of generating appropriate policy guidelines and incentives.

## VI. ACTIVITIES OF THE UNITED NATIONS SYSTEM

88. Organizations of the United Nations system have provided, within their spheres of competence, opportunities for the exchange of experience and information on the role of the public sector in promoting economic and social development in developing countries. In the last four years, each organization has convened several interregional and expert meetings to review various aspects of the public sector. This includes such subjects as

institutional reform and its management systems and practices, public financial management, performance of public enterprises and related subjects such as divestment. Based on these meetings and other research studies, each organization has also published monographs and disseminated them to concerned agencies and countries.

89. Within the United Nations Department of Technical Cooperation for Development, the most recent meeting convened was an interregional seminar on the role of the public sector in promoting economic development of developing countries, which was organized in collaboration with UNEP at Nairobi in January 1991. In addition, several interregional meetings on the role of the public sector have been conducted and the related studies have been completed. The publications based on these meetings and studies since 1987 have included subjects on planning and control of public current expenditure (1987), government accounting and financial reporting in developing countries (1987), the role and extent of competition in improving the performance of public enterprises (1989), government financial management in least developed countries (1989), application of audit standards in developing countries (1990), policy development for increasing the role of women in public management (1987), management development for senior administrators (1987), management of government information systems (1989) and corruption in government (1990).

## VII. CONCLUSIONS

90. While the public sector continues to play a significant if not dominant role in the economic development of developing countries, there are increasing signs that this role is being reconsidered for both internal and external reasons. Individual country situations vary in this respect, but what can be concluded is that although the overall significance of the role of the public sector as chief custodian of political and economic decision-making remains more or less unchanged, the scope and content of that role is changing, particularly in its macro-dimensions. Changes here include the more pronounced need for a stable framework of law or the rule of law and a correspondingly "open" judicial system, improved infrastructure support in physical and human services, guidance and coordination in strategic economic policy-making, multisectoral participation in economic and commercial operations, and a supportive role in promoting the private sector.

91. Governments have embraced the challenges of formulating and managing macroeconomic reforms to differing degrees. Generally, the processes of change and reform have been slow and often very difficult. In many cases, the promise and prospect of restructuring and reform have yet to be fulfilled.

92. Although progress has been slow and difficult, Governments of developing countries continue to experiment with policy development concerning the role of the public sector in economic development. The main considerations in this policy development process are the functions the public sector can perform most effectively, the functions best left to the private and non-governmental

sectors to perform and how the public sector can effectively promote and link up with those sectors to encourage a productive intersectoral partnership.

93. Although a tailored approach is likely to prove most appropriate, there are nevertheless common guidelines that should be kept in mind by all countries seeking to redefine the role of the public sector:

(a) Policy makers need to set realistic development goals and identify workable approaches and feasible strategies for achieving these goals. At the minimum, this process should seek to address the public sector's role in providing a stimulative regulatory environment; providing improved guidance, both direct and indirect, for strategic economic decision-making and management; and renovating, where indicated, commercial and business undertakings of the public enterprise sector;

(b) As a rule, the public sector should, where appropriate, correct the common practice of neglecting to place strong emphasis on the provision of a stable regulatory framework and the rule of law. Effective performance in this regard is indispensable to the development of a sense of security and respect for individual property rights, a condition vital for steady economic growth and innovation;

(c) If seeking to reduce the role of the public sector in business and commercial operations, Governments should encourage a gradual increase in the private sector's responsibilities for most commercial activity through a policy of incentives and support, leaving only the economic regulatory function and provision of public goods and services with the public sector;

(d) The public sector should seek to reform itself where feasible and possible. In so doing, it needs to give precedence to nation-building requirements in the form of creating national identity, interest, commitment and consensus, without which economic growth cannot occur.

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